

THE MACHINERY FOR RAISING CAPITAL BY COMPANIES THROUGH DEBT FINANCE

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ABSTRACT

This paper examines the legal nature of debenture as a vehicle for easy access to finance by companies and as a secured credit. The machinery for raising capital through debenture is not well articulated in the Companies and Allied matters Act 1990. The position of the law on the rights and duties of the parties to a floating charge is inadequate and reforms are urgently required as the current provision of the law allows for fraud on unwary parties.

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INTRODUCTION

Companies like any other natural person is entitled to raise debt finance to enhance its activities. The way and manner of going about this is also very numerous, it may raise loan from a bank either secured or not, it may ask its customers to deposit money with it before being supplied with products of the company, it may acquire its assets by leasing them, or it may raise securities in the public market with incentives to buy back its debt at a later specified date. This last option is better known as “Debenture”. In this paper, we will critically examine the legal machinery for creating debenture by companies, rights of the debentures holders and methods of enforcement of the debenture in Nigeria.

LEGAL NATURE OF DEBENTURES AS SECURITY

The company may exercise options as to which procedure to adopt in raising capital. The company may create and publicly sell its shares and raise capital to finance its operation or it may create a series of debenture stocks also sold publicly with the same intention. One creates shareholders who have rights exercisable in the company while the other creates debenture holders who have rights against the company. Though in most cases the debenture gives the same rights to the debenture

holders as that of the shareholders, e.g. the power to appoint directors, to share in the profits (whether dividends are declared or not) to attend and vote at general meetings, and even to convert debenture into equity share. In some cases, the debenture may give the holders considerable influence over the way in which the company is managed. Where the debenture is secured by a fixed charge over the property of the company it may in fact be an ordinary mortgage with the same rights and incidents of ordinary mortgage transactions while it may be secured with a floating charge over the undertakings of the company, the holder will have both legal and equitable rights and interests in the company's business, quite very different from its shareholders¹.

The major differences between a shareholder and debenture holder are:

- (1) The holder of a debenture is not a member of the company, whilst a shareholder is a member of the company².
- (2) Debenture may be issued at a discount; shares may not be except under stringent conditions³.
- (3) A company may purchase its own debenture, but it must not purchase its own shares⁴.
- (4) Interests at the specified rate in the debenture may be paid out of capital; dividends on shares must be paid out of profits⁵.
- (5) Debenture holders are entitled to repayment of their loan before the shareholders during winding up⁶.

¹ Paul L. Davies, Gower and Davies, Principles of Modern Company Law, 7th ed. Sweet and Maxwell p. 806

² Section 114 of Companies and Allied Matters Act 1990 (CAMA), see also *Burland Trustee v Steel (1901) 1 Ch. 279 at 288*

³ Section 130 CAMA 1990

⁴ Section 159, and section 160 CAMA 1990

⁵ Section 379 and section 380 CAMA 1990

⁶ Section 437 CAMA 1990

The law permits the company to borrow money for the purpose of its business or objects and by virtue of section 166 of the Companies and Allied Matters Act 1990 (CAMA 1990)⁷. The company may “mortgage or charge its undertaking, property and uncalled capital, or any part thereof and issue debentures, debenture stock and other securities whether outright or as security for any debt, liability or obligation of the company or of any third party.” Put simply, a debenture is merely the document that evidences the company’s debt⁸.

DEFINITION

The word debenture does not have a simple and clear cut definition. In fact Lindley J had pounded on the exact definition and concluded thus,

*“what the correct meaning of ‘debenture’ is I do not know, I do not find anywhere any precise definition of it. We know that there are various kinds of instruments commonly called debentures. You may have mortgage debentures, which are charges of some kind on property. You may have debentures which are bonds... You may have a debenture which is nothing more than an acknowledgement of indebtedness. And you may have a thing like this, which is something moves, it is a statement by two directors that the company will pay a certain sum of money on a given day, and will also pay interest half-yearly at certain times and at a certain place, upon production of certain copious by the holder of the instrument.”*⁹

Chitty J in the same vein, observed as follows:

*“I cannot find any precise definition of the term, it is not either in law or commerce a strictly technical, term or what is called a term of art.”*¹⁰

However, the Acts had constantly referred to the word ‘debenture’ and has provided copious provisions on debenture¹¹ in Nigeria, the CAMA 1990 defines debenture as,

⁷ Cap. Laws of the Federation of Nigeria 2004

⁸ *Levy v Abercorris State and Slab Co. (1887) 36 Ch.D 215 per Chitty J., Knightsbridge Estates Trust v Byrne (1940) AC 613*

⁹ *British India Steam Navigation Co. v IRC (1881) 7 Q.B.D. 172*

¹⁰ *Levy v Abercorris Slate and Slab Co. supra p. 260 at 264*

“a written acknowledgement of indebtedness by the company setting out the terms and conditions of such indebtedness and includes debenture stock, bonds and any other securities of a company whether constituting a charge on the assets of the company or not.”¹²

The Court of Appeal in Nigeria, also attempted to define the word debenture as constituting a debt owed by a company to another, secured by a deed, which prescribes the conditions of the realization of the debt¹³.

In United Kingdom, the Financial Services Market Act 2000 (FSMA 2000) defines debenture in an inclusive term, “...including debenture stock, loan stock, bonds, certificates of deposit and other instruments creating or acknowledging indebtedness while, the Company Act 2006 (U.K) repeated the provisions of the 1985 Companies Act (U.K) as “debenture” includes debenture stock, bonds and any other securities of a company, whether or not constituting a charge on the assets of the company or not.”¹⁴

Obviously, the definitions in the various Acts are merely description of what the debenture is but not a definition of the term, clearly, both judicial and legislative definitions give some form of descriptions as to what debentures is all about, both in law and commerce would for most purposes be regarded as its essential feature, namely that debentures are a type of transferable security (in this respect resembling shares) whereby a company can raise finance in the form of loan capital instead of share capital¹⁵.

CREATION OF DEBENTURES

In modern commercial usage a debenture is an instrument issued by the company, normally-but not- necessarily – called on the face of debenture and

¹¹ Schedule 1, Para 2 of the FSMA 2000 (U. K)

¹² Section 650 CAMA 1990

¹³ *Union Bank of Nigeria Ltd and Others v Tropical Foods Ltd* (1992) 3 NWLR (pt 228) 231 CA

¹⁴ Section 738, Companies Act 2006 (U.K) see also section 744 Companies Act 2005 (U.K)

¹⁵ Jelili Omotola, *The Law of Secured Credit*, Evans Brothers Nigeria Publishers Ltd, 2006 p. 165

providing for the payment of, or acknowledging the indebtedness¹⁶ in a specified sum at a fixed date, with interest thereon. In creating a debenture therefore, by virtue of section 168 of the CAMA 1990, every debenture must include statements on the following matters:-

- (a) The principal sum borrowed;
- (b) The maximum discount which may be allowed on the issue or re-issue of the debentures and the maximum premium at which the debentures may be made redeemable;
- (c) The rate of and the dates on, which interest on the debentures issued shall be paid and the manner in which payment shall be made;
- (d) The date on which the principal amount shall be repaid or the manner in which redemption shall be effected, whether by the repayment of installments of the principal or otherwise;
- (e) In the case of convertible debentures, the date and terms on which the debentures may be converted into shares and the amount which may be credited as paid up on those shares and date and terms on which the holders may exercise any right to subscribe for shares by virtue of the debentures held by them;
- (f) The charges securing the debentures and the conditions subject to which the debenture shall take effect. Statements made in debenture or debenture stock certificate shall be **prima facie** evidence of the title to the debentures of the person named in the certificate as the registered holder and of the amount secured thereby¹⁷. And where any person relies on the statements contained in a debenture to his detriment, the company is estopped in favour of such person

¹⁶ *Gardner v London Chatham and Dover Rly* (1867) L.R. 2 Ch. 201

¹⁷ Section 169 CAMA 1990

from denying the continued accuracy of such statements and the company must compensate such person for any loss suffered by him in reliance thereon and which he would not have suffered had the statement been or continued to be accurate¹⁸.

The contents of the debenture are basic terms in any good debt contract agreement and necessary for containing of terms. A contract with a company to take and pay for any debenture of the company is enforceable by specific performance order by the court¹⁹.

The term of the debenture must be certain and easily understandable, and where it is not certain the court may declare such charge as void and of no effect²⁰.

Every company must within sixty days after the allotment of its debenture or after the registration of the transfer of any debenture, deliver to the registered holder thereof, the debenture or a certificate of the debenture stock under the common seal of the company²¹. There is a difference between allotment of debenture and registration of transfer. The law provides that every charge created by companies must be registered within ninety days²². It means that the certificate of title to the debentures must be given to the holder within sixty days notwithstanding that it has been registered or not. Where there has been a transfer of the debenture stock, the company still has up to sixty days within which to release the certificate. The time given is not only very long but it is not commercially friendly. The title owner of a debenture will be unable to transfer his title if he does not have a certificate evidencing his right to the debenture. Because the debenture certificate represents the bundle of rights and

¹⁸ Section 169(2) CAMA 1990

¹⁹ Section 170 CAMA 1990, section 740 C.A (U.K)

²⁰ *Izzet v Lee Ranker* (1971) 1 NLR 1788. Here a clause in a mortgage contract, which was stated to be subject to a satisfactory mortgage was held void because of uncertainty. The clause is supposed to be conditional finance clause that will state all the terms of the loan but it did not, hence it was void.

²¹ Section 161(1) CAMA 1990

²² Section 197 CAMA 1990

privileges of the debenture holder, such rights and privileges are in everyone while the certificate is not ripe under the law to be issued. It is clear that the law merely sets the maximum time limit for the issuance of the debenture certificate, the companies need not wait till sixty days limit but ought to issue it as soon as possible upon registering in their debenture register²³.

The position in U.K will be a better option, the law in U. K is that “any holder of debentures a company is entitled, on request and on payment of such fee as may be prescribed, to be provided with a copy of any trust deed for seeing, the debentures²⁴.” The Nigerian position may adopt this position, so that the delivery of certificate is based on request and payment of prescribed fees. This may save the problem of complying with time constraints and the challenge of expenses of producing the certificate or the trust deed is settled.

The law provides for every company that has issued a debenture or series of debentures to keep a copy of every instrument creating any charge requiring registration, to be kept in the head office of the company²⁵. The company must also keep a register of charges created²⁶ and also maintain a register of debenture holders²⁷. The register must contain the following information:

- (a) The names and addresses of the debenture holders;
- (b) The principal of the debentures held by each of them;
- (c) The amount or the highest amount of any premium payable on redemption of the debentures;
- (d) The issue price of the debenture and the amount paid up on the issue price;

²³ Section 193 CAMA 1990

²⁴ Section 749 C.A 2006 (UK)

²⁵ Section 190 CAMA 1990

²⁶ Section 191 CAMA 1990

²⁷ Section 193(1) CAMA 1990

(e) The date on which the name of each person was entered on the register as a debenture holder; and

(f) The date on which each person ceased to be a debenture holder²⁸.

The entry must be made within thirty days of the holder's conclusion of the agreement with the company, or within the same period in case of ceasing to be a debenture holder.

²⁸ Section 193(2)

TYPES OF DEBENTURES

1. PERPETUAL OR IRREDEEMABLE DEBENTURES

Generally, a mortgage cannot be made irredeemable. Equity will declare void any provision in a mortgage that makes or have the effect of making a mortgage irredeemable or perpetual. The mortgagors right to redeem must remain unfettered, however, this rule does not apply to companies. perpetual debentures may be created and a condition in a debenture is not void on the grounds that it is irredeemable or redeemable only on the happening of a contingency however remote, or on the expiration of a period of time however having any rule of equity to the contrary notwithstanding²⁹.

2. CONVERTIBLE DEBENTURES

The terms on which debentures are issued may provide that in lieu of redemption or repayment. They may, at the option of the holder or the company be converted into shares in the company on such terms as are in the debenture³⁰. Upon conversion the debenture holder becomes a shareholder and ceases to be a creditor.

3. SECURED OR NAKED DEBENTURE

A debenture may be secured by a charge over the company's property or may be unsecured by any charge. Unsecured debentures or naked debentures as they are sometimes called are short-term notes of indebtedness given by companies to holders. Secured debentures are used for medium and long-term borrowing. Debentures may be secured by a fixed charge of a specific part of the company's undertaking and

²⁹ Section 171 CAMA 1990

³⁰ Section 172 CAMA 1990

assets, or by both a fixed charge on certain property and is floating charge³¹. The charge is enforceable on the occurrence of the events specified in the debentures or the deed securing it. If a debenture or holder share to enforce the security of a series of debentures of which he holds part, he must she in a representative capacity on behalf of himself and all other debenture holders in that series³².

4. REDEEMABLE DEBENTURES

A company limited by shares, is entitled to issue debentures, which are, or at the option of the company, liable to be redeemed³³. The company is also empowered to re-issue any debenture, if there is no provision express or implied to the contrary in the articles, or in any contract entered into by the company or the company has, by passing a resolution to the effect or by some other act manifested its intention that the debentures shall be cancelled the company shall have had, and shall be deemed always to have had power to re-issue the debentures either by re-issuing the same debenture or by issuing other debentures in their place³⁴.

DEBENTURE STOCKS AND TRUST DEED

Every company before issuing debentures to the public for subscription or purchase must execute debenture trust deed in respect of them and procure the execution of the deed by the trustee for the debenture holders appointed by the deed³⁵.

A debenture trust deed must contain the following terms³⁶:

1. A covenant by the company for payment to the debenture holders of the principal moneys and interest

³¹ Section 173 (2) CAMA 1990

³² Section 173 (3) CAMA 1990

³³ Section 174 CAMA 1990

³⁴ Section 175 CAMA 1990

³⁵ Section 183(1) CAMA 1990

³⁶ See section 184 CAMA 1990

2. Charges giving the trustees a legal mortgage by demise of the company's freeholds and leaseholds, which are specific and a floating charge over the rest of the undertaking and property.
3. A clause specifying the events in which the security is to become enforceable e.g. default in the payment of interest or principal moneys, order made or resolution passed for winding up, appointment in Nigeria of a receiver, cessation of business, breach of covenant by the company.
4. A clause giving the trustees power to take possession of the property charged when the security becomes enforceable, to carry on the business and to sell property charged and to apply the net sale moneys in payment of the principal and interest and to pay the balance to the company.
5. Power for the trustees to concur with the company in dealings with the property charged.
6. Covenants by the company to keep a register of debenture holders, to insure and keep in repair the property charged
7. Provision or meetings of debenture holders
8. Power for the trustees to appoint a receiver when the security becomes enforceable³⁷.

In addition, the debenture trust deed not only constitutes the stock but also acknowledges the indebtedness of the company to the trustees for the specified sum and provides for the issue of the debenture stock certificates.

The deed must also state whether the rights of debenture holders may be altered or abrogated and if so, the conditions which must be fulfilled, and the procedure which must be followed, to effect such on alteration or abrogation. The

³⁷ Omotola op. cit p. 167

deed must also include the amount or rate of remuneration to be paid to the trustee and the period for which it shall be paid and whether it shall be paid in priority to the principal, interest and costs in respect of debentures issued under the trust deed³⁸.

Where the debenture is unsecured, the company must state on its face in clearly legible print that it is unsecured if no mortgage, charge or security is vested in the holder of the debenture or in any other person for his benefit as security for the payment of principal and interest³⁹. In cases where the debenture is secured by a fixed charge, the deed must show whether the trustee of the covering debenture trust deed holds the mortgages charges and securities vested in him by the trust deed in trust for the debenture holders equally or in trust for some only of the debenture holders equally, or in trust for some only of the debenture holders, and if so which debenture holders and whether the debenture is secured by a general floating charge vested in the trustee of the covering debenture trust deed or in the debenture holders⁴⁰.

The debenture trust deed has several advantages, some of which are highlighted below:-

- i. The trustees will have a legal mortgage over the company's hand, so that persons who subsequently lend money to the company cannot gain priority over the debenture holders or debenture stockholders.
- ii. The deed normally specifies actions to be taken in the event of any occurrence and the persons who are responsible for taking such actions, so that the rights of the holders are not left without fast remedy.
- iii. The company is given a number of powers over the property mortgaged with the consent of the trustees e.g. power of sale, This enables the company to use the property advantageously for the purpose of its business

³⁸ Section 184(1) (m) (n). CAMA 1990

³⁹ Section 185(2)

⁴⁰ Section 185(1)

without prejudicing the interests of the debenture holders or debenture stockholders.

- iv. Covenants are entered into by the company for insurance, repair and other matters and can be enforced by the trustees.
- v. Power is given to the trustees to appoint a receiver or to enter into possession of the property and carry on the business of the company in case of urgency⁴¹.

REMEDIES OF DEBENTURE HOLDER

The remedy available to a debenture holder depends on whether the debenture is secured by a charge or not. Where the debenture is secured by a charge his position is stronger than where the debenture is unsecured. Where the debenture is secured, the debenture holder has available to him the following remedies.

(i) Action by debenture holder

Any debenture holder may sue the company in the event of default in payment of the interest and or principal sum. And the court will usually appoint a receiver (manager) and may order the sale of the company's properties⁴².

(ii) Valuation of Security

If a company is insolvent and is being wound up, a debenture holder may value his security and prove for the balance of the debt, or he may surrender his security and prove for the whole debt.

(iii) Foreclosure

A debenture holder may apply to the court for a foreclosure order. This is rarely applied for, as all the debenture holders must be parties to the action. It has the

⁴¹ Paul Davies, op. cit p. 813

⁴² See *Macauley v Nal Merchant Bank* (1990) NWLR (pt 144) 1283 SC.

resultant effect of vesting the title in the property in the debenture holders, free from the company's equity of redemption (i.e. the company's right to repay the loan and recover its property free from the sale.

(iv) Sale

The power of sale must be included in a trust deed, where this is done; the trustee may without recourse to the court sell the security. Where the debenture trust deed does not provide for the power of sale, then the trustee must first apply to the court for an order to sell the security.

(v) Receiver

The most popular remedy is the appointment of a receiver. This is also normally included in a trust deed, where this is not done, then the trustee must first seek the order of court before he can appoint a receiver⁴³.

(vi) Winding up

As a creditor, the debenture holder may present a petition for winding up of the company as a creditor for the amount of his principal and interest but not for every premium payable on redemption, unless the debenture expressly so provides⁴⁴.

FIXED CHARGE

A fixed charge is defined as "a specific charge, one that without more fastens on ascertained and definite property on property capable of being ascertained and defined⁴⁵. Generally, the borrower is obliged to provide a security for the loan obtained. This also applies to the company, as debenture issued by a company will be

⁴³ *Under-contractors Nig. v UAC* (1988) 2 NWLR (pt 76) 303 SC; *Olukoya v Santili* (1990) 2 NWLR (pt 131) 172 Sc

⁴⁴ *Consolidated Goldfields of South Africa v Summer and Jack East* (1913) 82 LJ Ch. 214

⁴⁵ Lord Machaughten in *Illingworth v Houdsworth* (1904) A.C. 355

secured over the company's assets. Browne-Williams V-C attempted to describe security interest, when he said,

“Security is created where a person (the creditor) to whom an obligation is owed by another (the debtor) by statute or contract, in addition to the personal promise of the debtor to discharge the obligation, obtains rights exercisable against some property in which the debtor has an interest in order to enforce the discharge of the debtors obligation to the creditor⁴⁶”.

This description certainly brings out the essential feature of a security or charge as the ultimate plan is to give the holder of the security some form of proprietary claim over debtor's assets, to secure payment of the debt.

A charge has also been defined as the appropriation of real or personal property for the discharge of a debt or other obligation⁴⁷. The fixed charge results in the immediate acquisition of rights over the property by the charge. Thus in the event of default, the fixed charge has immediate real rights as opposed to personal rights. Due to uncertainties in realizing the securities and the general problems of when and how floating charge crystallize, charges prefer fixed charge are therefore possible over classes of assets such as, shares and other investments held in other companies, patents, trademarks, designs, copyrights, and other industrial intellectual property rights, concessions, franchises, and book debts or amounts recoverable from third parties⁴⁸.

A fixed charge imposes a restriction on the chargor's right to deal on the charged assets, such that, although both forms of charges are present securities. The main difference between the two, prior to crystallization has in the effect of

⁴⁶ *Bristol Airport Plc v Powdrill* (1990) Ch. 744 at 760

⁴⁷ F. W. Fisher and J. M. Lightwood, *Law of Mortgages*, 9th edition, London 1977

⁴⁸ R.R. Renington, “Fixed Charges Over Future Asset of a Company”, *the Company Lawyer*, Vol. 6 No. 1 at 13

management autonomy and freedom of dealing given to the borrower in respect of the charged assets⁴⁹.

The most important question to ask in respect of creation of security interests by a company are, whether the charge is fixed or floating? Secondly, whether the interest created is equitable or legal, the resolution of the second question enables us to determine the issue of priorities⁵⁰. The third consideration is whether the security interest is possessory⁵¹. Fourthly, what type of proprietary interest is vested in the chargee by the charge? This has direct bearing on the remedies available. The fifth consideration is whether the security interest is one that is created by the parties to it or is it one created by operation of law? This is important in order to determine the critical point of registration of the charge. Lastly, whether the charge is registrable under the provisions for the registration of company charges?⁵²

However, the most important feature of the fixed charge, in whatever form it features is that the rights of the creditor (chargee) are attached immediately to the property and the company's (chargor's) power to deal with the asset is restricted. The company will thus have to obtain the creditor's consent before it deals with the charged asset. Lord Millet stated in *Agnew v Commissioner of Inland Revenue*⁵³ that,

“A fixed charge gives the holder of the charge an immediate proprietary interest in the assets subject to the charge which bonds all these into whose hands the assets may come with notice of the charge.”

⁴⁹ Fidelis Oditah, *Legal Aspects of Receivables Financing*, Sweet and Maxwell, 1991, W.J. Gough, *Company Charges*, 2nd Edition, 1978 at 92 – 93.

⁵⁰ Priorities will be considered below

⁵¹ Paul Davies op. cit pp 815-816

⁵² See generally, Goode, *Commercial Law* (2nd ed. London 1995)

⁵³ (2001) 2 AC 710

FLOATING CHARGE

As the name suggests, a floating charge floats over the whole or a part of the chargor's assets which may fluctuate as a result of acquisitions and disposals. Corporate property that can be made subject to a floating charge includes stock in trade, plant and book debts (receivables)⁵⁴. Individuals cannot grant floating charges⁵⁵.

A floating charge has been described as one of the most, subtle creations of equity and remains conceptually elusive⁵⁶, Jessel MR in the case of *Re Florence Land and Public Works Co*⁵⁷ described a floating charge as, 'a charge on the property of the company as a going concern, subject to the powers of the directors to dispose of the property of the company while carrying on its business in the ordinary course', where Lord Justice James is of the view that the floating charge is, "a charge on the assets of the company for the time being, which does not prevent the company from carrying on its business"⁵⁸. The floating charge originated as a device for giving effect provisions in family settlements and wills for settlement of family acquired property⁵⁹.

It is therefore a valuable and flexible means of raising money, without removing any of its properties from the company. Also, it helps in the granting of security over assets which in the normal course of a company's business are circulating e.g. stock in trade. The company will be free to control and deal with the properties subject of the charge until the charge is converted into a fixed charge⁶⁰.

⁵⁴ R. M. Goode, *Legal Problems of Credit and Security*, 3rd ed., (Sweet and Maxwell) London 2003 p. III

⁵⁵ Because of the legal requirement that the goods charged must be specifically described in the instrument. See Bills of Sales Act 1878

⁵⁶ R. M. Goode, op. cit footnote 54

⁵⁷ (1878-9) 10 Ch.D 530 at 547

⁵⁸ Ibid

⁵⁹ R.R. Renington, 'Fixed charges, over future assets of a company', *Lawyer*, Vol. 6 No. 1 at 13

⁶⁰ The event known as crystallization

No particular form of words is necessary to create a floating charge; the intention of the parties to create one is the most important consideration⁶¹. The intention must reveal (1) that the parties intend to impose a charge on assets both present and future (2) the assets are of such a nature that they would be changing in the ordinary course of the company's business (3) the company is free to continue to deal with the assets in the ordinary course of its business⁶². The nomenclature adopted does not matter, the general test is, if the company is free to use the assets in the normal course of its business then it will be treated as a floating charge.⁶³

Romer J in the case of *Re Yorkshire Woolcombers Association*⁶⁴, listed the following distinguishing features of a floating charge,

*“it is a charge on a class of assets of a company present and future; that is class is one which in the ordinary course of the business of the company, would be changing from time to time, and you find that by the charge it is contemplated that, until some future step is taken by or on behalf of those interested in the charge, the company may carry on its business in the ordinary way as far as can the particular class charged”*⁶⁵

Lord Philips MR noted that⁶⁶ initially it was not difficult to distinguish between a fixed and a floating charge. A fixed charge arose where the chargor agreed that he would no longer have the right of free disposal of the assets charged, but that they should stand as security for the discharge of obligators and to the charge. A floating charge was normally executed by a company which wished to be free to acquire and dispose of assets in the normal course of its business, but nonetheless to make its assets available as security to the charge in priority to other creditors should

⁶¹ *Agnew v Commissioner of Inland Revenue* op. cit

⁶² Paul Davies, op. cit p. 818-819

⁶³ *Re Armagh Shoes Ltd* (1984) B.C.L. 405, *Re Yorkshire Woolcombers' Association Ltd* (1903) 2 Ch 284 at 295

⁶⁴ (1903) 2 Ch. 284

⁶⁵ See also *Re Bond Worth Ltd* (1980) Ch. 228

⁶⁶ In *National Westminster Bank Plc v Spectrum Plc Ltd* (2004) EWCA Civ. 670

it cease to trade. The hallmark of the floating charge was the agreement that the chargor should be free to dispose of his assets in the normal course of business unless and until the chargee intervened. Up to the moment the charge floated.

In deciding whether a charge is a floating charge, the nature or form of the property involved is not of paramount consideration but the degree of freedom accorded to the company to deal with this property in the normal course of business. Irrespective of what the parties call it, the substance is the paramount consideration. Lord Millet⁶⁷ explained that, ‘in deciding whether a charge is a fixed or a floating charge, the court is engaged in a two-stage process. At the first stage it must construe the instrument of charge and seek to gather the intentions of the parties from the language they used. But the object at this stage of the process is not to discover whether the parties intended to create a fixed or a floating charge. It is to ascertain the nature of the rights and obligations which the parties intended to grant each other in respect of the charged assets. Once these have been ascertained, the court can then embark on the second stage of the process, which is one of categorization. This is a matter of law. It does not depend on the intention of the parties. If their intention, properly gathered from the language of the instrument is to grant the company rights in respect of the charged assets which are inconsistent with the nature of fixed charge, then the charge cannot be a fixed charge however they may have chosen to describe it.’ Lord Millet agreed that Romer LJs⁶⁸ distinguishing feature is the classic hallmark of a floating charge.

A classic example presented itself in the case of *Arthur D Little Ltd v Ableco Finance LLC*⁶⁹, the company Arthur D. Little Ltd, guaranteed the liabilities of its two parent companies to Ableco by creating a charge, described as a first charge, over its

⁶⁷ *Agnew v Commissioner of Inland Revenue op. cit.*

⁶⁸ *Re Yorkshire Woolcombers Association op.cit.*

⁶⁹ (2002) 2 BCLC 799

shareholding in a subsidiary company CCL. The chargor company retained both its voting and dividend rights with respect to the shares. The company's administrator argued that it was a floating charge. It was held applying Lord Millets reasoning in *Agnew*, that it is a question of law whether or not the charge was fixed or floating. The particular charge in issue was fixed. Because, it did not float over a body of fluctuating assets and notwithstanding the company's voting and dividend rights, it could not deal with the asset in the ordinary course of business, the company could not dispose of, or otherwise deal with the shares. The asset was still therefore under the control of the chargee.

The object of the floating charge has always been identified as a means of providing the company with capital using the existing and future assets of the company as security and yet having full control of the assets in question⁷⁰. In the words of Lord Phillips MR⁷¹, the object of the floating charge was to provide security to the charge in a form that would not inhibit the chargor from continuing to carry on its business. Romer J agrees that floating charges 'constitutes a charge but give a license to the company to carry on its business.'⁷²

The basic characteristic has been that 'the company will go on, and that the debenture holder could not interfere until either the interest, which was unpaid, or until the period had arrived for the payment of his principal and same is yet unpaid'⁷³. Based on the agreement between the parties, where there is no default the company enjoys unrestricted freedom in the way and manner it deals with its assets in spite of the existing charge⁷⁴.

⁷⁰ See Gifford L.J. in *Re Panama New Zealand and Australian Royal Mail Co* (1876) 5 Ch. App. At 3418

⁷¹ *National Westminster Bank Plc v Spectrum Plus Ltd* op. cit.

⁷² *Robson v Smith* (1895) Ch. 118 at 124

⁷³ Gifford, L.J. in *Re Panama New Zealand and Australian Royal Mail Co*. op. cit

⁷⁴ *Government Stock Investment Co v Manila Railway* (1904) AC 355

The floating charge is not in fact a specific mortgage of the assets of a company⁷⁵ as the chargee cannot claim the particular assets mortgaged and therefore unidentifiable⁷⁶.

There has been some confusion whether the floating charge is a present charge only on the assets for the time being of the going concern or it should be appropriately regarded as covering both present and future assets of the company. In the view of Lord Macnaughten⁷⁷, ‘a floating charge is an equitable charge on the assets for the time being of a going concern. It attaches to the subject charged in the varying conditions in which it happens to be from time to time. It is of the essence of such a charge that it remains dormant until the undertaking charged ceases to be a going concern or until the person in whose favour the charge is created intervenes.’ While in Romer J’s view when giving the three classical characteristics of a floating charge actually pointed out that ‘it is a charge on a class of assets of a company present and future.’⁷⁸ In the view of Kito J in *Stein v Saywell*⁷⁹ when he identified a distinct feature of a floating charge he noted thus,

“it is not of course a distinguishing feature though it is a feature, of a floating charge that it attaches to future-acquired property. Its distinguishing feature is that the class of present and future assets that are charged being such as in the ordinary course of the company’s business would be changing from time to time, the company’s is left at liberty, until one of the crystallizing events happens, to dispose freely, in the ordinary course of its business of any property to which it attaches.”

The courts seem to be saying the same thing in different ways, the floating charge though a present charge but attaches on both present and future assets of the company. Fletch Moulton L.J while approving the views of Lord Macnaughten in

⁷⁵ *Evans v Rival Grounds Quarries* (1910) 2 KB at 979

⁷⁶ See Fletch Moulton L.J in *Government Stock Investment Co v Manila Railway* (1904) AC 355

⁷⁷ *Government Stock Investment Co v Manila Railway Co op.cit.* at 355

⁷⁸ *Re Yorkshire Woolcombers Association Ltd op. cit* at 297

⁷⁹ (1969) 121 CLR 529 at 556

*Government Stock Investment Co. v Manila Railway Co*⁸⁰, said that his explanation removes all difficulties, ‘arising from the decisions, which speak of a floating charge as an existing charge. It is an existing charge and is rightly termed so, but care must be taken to remember that it has not settled down and fastened on the property, which is the subject of the charge, I find no difficulty in grasping such a concept⁸¹.

The CAMA 1990 condensed all the views above discussed when it describes without attempting to define the floating debenture as,

*“on equitable charge over the whole or a specified part of the company’s undertakings and “assets”, including cash and uncalled capital of the company both present and future, but so that the charge shall not preclude the company from dealing with the asset.”*⁸²

From the above analysis, the words to look for in a floating charge should be

- (1) Undertaking
- (2) Changing assets that is in varying conditions in which they happen to be from time to time
- (3) The assets for the time being
- (4) Ordinary course of business.

The traditionally regarded important aspect of a floating charge is the creation of a floating security and the demonstration of contractual intention of the parties that what is charged is some element of the business of the debtor company as a going concern⁸³.

⁸⁰ Op. cit

⁸¹ *Evans v Rival Grounds Quarries* (1910) 2 KB at 994

⁸² Section 178(1)

⁸³ Omotola op. cit p. 189

CREATION OF A FLOATING CHARGE

There is no special or particular form required for the creation of floating charge. The most important consideration is that the basic essence and nature of a floating charge exists. The charge depends on the contractual terms evidencing the intentions of the contracting parties⁸⁴. Speight J explained the position thus,

*“After all, a floating charge is not a work of art; it is a description for a type of security contained in a document, which may provide a variety of circumstances whereupon crystallization takes place. There is no magic in the particular form of words used in the security contract creating a floating charge. A floating charge may be property or ‘undertaking’. On and, the use of such expressions, even where coupled by way of emphasis with the words ‘floating security, does not automatically and without more create a floating charge. What has been traditionally regarded as important in the creation of floating security is the demonstration of contractual intention of the parties of which such expressions no doubt might be good and normally sufficient evidence that what is charged is some element of the business itself of the debtor company as a going concern.”*⁸⁵

The judicial authorities⁸⁶ and learned writers⁸⁷ agreed that the effect of a floating charge is not based on the wording used to create same but on the nature of the charge⁸⁸. Therefore there must be the intention expressed contractually as between the parties to create a charge over the undertaking and the assets of the chargor company, for the time being while continuing in business and to be left free to deal with the assets so charged in the ordinary course of business⁸⁹.

REGISTRATION

Registration is actually an instrument aimed at the registration of competing interests, subsequent charges, absolute purchase interests, unsecured creditors,

⁸⁴ See Fletcher Moulton L.J in *Evans v Granite Quarries Ltd* op. cit at 991

⁸⁵ *Re Manurewa Transport Ltd* (1910) 2 KB 979

⁸⁶ See Banks L.J in *National Provincial and Union Bank of England v Chorley* (1924) 1 KB 431

⁸⁷ W.J. Gough; *Company Charges*, Butterworths, 2nd edition, London 72 F. Oditah op.cit 207

⁸⁸ *Re Panama, New Zealand and Australian Royal Mail Co.* op. cit.

⁸⁹ See Gifford L.J. Ibid at 318

sanctions as to priority but more importantly against prejudice from the mischief of undisclosed charges⁹⁰.

Section 68 of CAMA 1990⁹¹ abolished the common law rule of constructive notice generally, but the same law still retains the rule as it applies to charges. Section 191 provides that every limited company must keep at the registered office of the company, a register of charges and enter therein all charges specifically affecting property of the company. The company must also register all floating charges on the company's undertaking or any property of the company. The law actually makes it an offence for omission to keep such register or failure to register a particular charge. The company must also allow inspection of the register with the accompanying instruments⁹². Whenever, the company refuses inspection of the register or the instruments creating charges, every officer who is in default is guilty of an offence⁹³. The company must also ensure that on the application of the transferor, of any debenture in a company. The company must register in its register of debenture holders, the name of the transferee in the same manner and subject to the same conditions as if the application for the entry were made by the transferee⁹⁴.

Section 197 of CAMA 1990 is particularly important as it provides, and this is notwithstanding the regime of registration within the company, that all charges created by the company must be registered with the Corporate Affairs Commission (C.A.C) within ninety days. Failure to register will render the charge void. We should note that it affects only creditor of the company, but it is still valid as between the chargee and chargor. In fact it makes the debt immediately payable. That a charge is

⁹⁰ Omotola op. cit p. 195

⁹¹ Section 191(2) CAMA 1990

⁹² Section 192 CAMA 1990

⁹³ Section 192 (2) CAMA 1990

⁹⁴ Section 195 CAMA 1990

registered in the company register of charges⁹⁵ or debentures⁹⁶ notwithstanding. A problematic provision is the registration within ninety days period. What happens within the ninety days if the company creates further charges which are now registered before the earlier ones, which were also registered within the ninety days period? Who takes priority?

Once registered, the charge is valid from the date of its creation. This results in a period of unavailability . In United Kingdom the period allowed is twenty-one days⁹⁷. This is because whenever anybody checks the register it cannot be assumed that the register is comprehensive because there may be a charge for which the ninety day period is still running⁹⁸.

When a charge is registered the C.A.C must issue a certificate setting out the parties to the charge, the amount thereby secured, with such other particulars as the commission may consider necessary. The certificate is a **prima facie** evidence of the compliance with the requirements as to registration. The charge cannot be set aside even if the particulars are incorrect⁹⁹.

Registration is a **perfection requirement**. It does not determine priority, which actually will depend on the date of creation of the charge. Creditors who ought reasonably to have searched the register and refuse to do so will be deemed to have constructive notice of it.

RECTIFYING THE REGISTER

The register of charges may be rectified where there is a mis-statement of any particular respect, or failure to register within the stipulated period was accidental or inadvertent or is not of a nature to prejudice creditors or shareholders of the company

⁹⁵ Section 191(1) CAMA 1990

⁹⁶ Section 193 CAMA 1990

⁹⁷ Section 395 1985 Companies Act, U.K

⁹⁸ See CLRSg's consultation document registration of company charges (October 2000) para 379

⁹⁹ *Re Eric Holmes (Property) Ltd* (1965) Ch. 1052; *Re CL. Nye Ltd* (1971) Ch. 442

or that on other grounds it is just and equitable to grant the relief¹⁰⁰. Generally, the leave to rectify the register out of time is granted by the court, subject to the rights of intervening secured creditors and provided the company is solvent¹⁰¹.

Upon the satisfaction of the debt or part thereof, or where any property or undertaking charged has been released from the charge, the commission may enter on the register or memorandum of satisfaction to give effect thereto and if required furnish the company a copy of the memorandum of satisfaction¹⁰².

CRYSTALLIZATION

Crystallization is a process whereby the charge attaches specifically to all the items of the class or charged assets, which the company owns at the date or subsequently acquires, if future assets are within the scope of the particular charge.¹⁰³

Upon the happening of the following events, these are:

- (a) The security becomes enforceable and the holder thereof relies on a power in that behalf in the debenture or the deed securing the same, appoints a receiver or manager or enters into possession of such assets; or
- (b) The court appoints a receiver or manager of such assets on the application of the holder; or
- (c) The company goes into liquidation.

The floating charge is said to crystallize and this has the effect of converting into a fixed charge on such of the company's assets as are subject to the charge¹⁰⁴.

¹⁰⁰ Section 205 CAMA 1990, Section 404 1985 C.A U. K

¹⁰¹ See, *Re K Johnson and Co Ltd* (1902) 2 Ch. 101

¹⁰² Section 204 CAMA 1990

¹⁰³ J.H. Farrar, 'The Crystallization of a Floating Charge' *The Conveyance*, Vol. 40 at 399

¹⁰⁴ Section 178 CAMA 1990

The debenture holder is empowered to voluntarily crystallize the charge by serving a notice on the chargor, or the crystallization may occur automatically upon the happening of a specified event in the debenture deed¹⁰⁵.

PRIORITIES OF FIXED AND FLOATING CHARGES

Since it is possible to create a floating charge and still retains control of the charged property, the company may go ahead to create further charges whether floating or fixed charge. Where there is no problem and the company is able to meet its obligations under the contract, all the parties are satisfied. However, where there is problem and the company is unable to meet its obligations, then, the next question is who takes first, in cases of multiple creations of charges?

The general rule is that the fixed charges on any property shall have priority over the floating charge affecting the property. Where the floating charge was created before the fixed charge, the fixed charged takes priority even with notice of the prior floating charge where there is no restriction to the creation of a fixed charge after the floating charge.

A specific charge takes priority over floating charge containing a restrictive clause, unless the specific charge has notice of the contractual restriction or terms of the restrictive clause.

As between two floating charges, the first in the takes priority. We must note that all the rules of priority will be of no effect where the property is taken over by a *bona fide* purchaser without notice.

¹⁰⁵ *Re Bright Life Ltd* (1981) Ch. 200

CONCLUSION

We have examined the machinery whereby companies may raise debt finance, which is much cheaper, simpler and flexible than equity finance. The debenture holder's while not being members of a company are actually having very powerful influence over the way the company is managed. The actual interplay of influence of the creditor with the management of the company, and various rules specifically designed to protect the investment of the debenture holders, also help to keep the company to continue as a going concern. The rules on registration help in determining priority and to notice to third parties and thus prevent fraud. . The law however needs to be reviewed in such a way that many loopholes like the ninety day rule in Nigeria is changed, either reduced or changed to one of immediate notification of such transaction to the commission, to ensure some level of certainty in this area of the law.

